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FROM CONFIDENCE TO CAUTION...

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THE CLIENT

Caída de las Reservas Internacionales...

- ¿Por qué no ha bajado el tipo de cambio no oficial?
 - ¿Hasta donde llegarán los precios?
 - ¿Venezuela llegará a una situación de incumplimiento de pago de su deuda?
 - ¿Qué va a pasar con el desabastecimiento?
 - ¿Nos vamos del fondo?
 - ¿Tendremos una banca "roja rojita"?
- Entérese el 30 de mayo en el Foro Interactivo de **Ecoanalítica**

De la confianza a la cautela Perspectivas 2007-2008.

Miércoles 30 de mayo de 2007
8:00 a.m. a 1:00 p.m.
Hotel Tamanaco Intercontinental
Salón Naiquatá

Para mayor información comunicarse con Natasha Quintana.
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We have modified our short-term economic outlook due to a series of negative news items that have arisen over the past few weeks. We have moved from a position of confidence to a position of caution. The main economic reason for this change is the fall in international reserves, as well as political themes such as the announcement of possible nationalizations, the withdrawal from the IMF, etc. If the fiscal policy does not change, which we expect will not happen, the increase in liquidity will overcome the possibility of accumulating reserves, the Bolivar will therefore have less and less support, putting pressure on the unofficial exchange rate and keeping inflation high and on the rise.

International reserves continue their free fall

During the first week of May, international reserves went down by US\$ 4.446 billion, closing on May 8 at US\$ 24.119 billion. Between the beginning of the year and May 8, international reserves have fallen by US\$ 12.553 billion, a drop of 34.2%. At *Ecoanalitica*, we do not share the President's viewpoint that reserves have been transferred simply "to take resources out of one pocket and put them in another"; what is more, if he must use this phrase, he should clarify that the pocket where those reserves are ending up has a hole in it.

FONDEN – a pocket with no bottom to it

There are several reasons why we do not support the transferring of resources to FONDEN. The first one is simply the lack of transparency and the higher levels of risk these resources are subject to. The second one is that these resources are meant to be spent and not to be used to prop up the Bolivar. According to figures made public by the Minister of Finance, Rodrigo Cabezas, through March 31 FONDEN had received US \$ 22.5 billion, of which US\$ 11.3 billion had been spent, leaving a balance of US\$ 11.2 billion. Of this balance, US\$ 5.0 billion was "disposable", and the rest - US\$ 6.2 billion - was invested in structured notes whose exchange value in hard currency is almost impossible to calculate. Several questions arise thus far: In which projects were these resources spent? Where is FONDEN exchanging its Dollars? Could FONDEN be the source for the resources used in the projects the President has promised overseas? Why were low-liquidity and high-risk structured notes purchased? etc.

For the remainder of the year, a further transfer to FONDEN of US\$ 2.3 billion is expected, and structured notes worth US\$ 1.7 billion will be maturing. In addition, US\$ 1.6 billion will be shelled out to purchase CANTV, and we believe that US\$ 6.3 billion, already pledged to myriad projects, will be spent. All of this said, and assuming both that there

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are no new PDVSA deposits and that no more money will be poured into new projects, FONDEN's balance at the end of the year will be US\$ 5.6 billion, US\$ 4.5 billion in structured notes and a mere US\$ 1.1 billion in cash. Unquestionably, these figures bear no resemblance to the "rules book" on how to manage international reserves.

Government Resources (FONDEN)

Million of US\$

To 31/03/07

Income	22.500
Expenditures	11.300
Remaining Balance	11.200
Structured Notes	6.200
Liquid Funds	5.000

Second Semester 2007

New transfer April - May, 2007	2.300
Payment CANTV	1.600
Awkward Funds	6.300
Maturity of Notes	1.700

Sources: BCV and Ecoanalítica

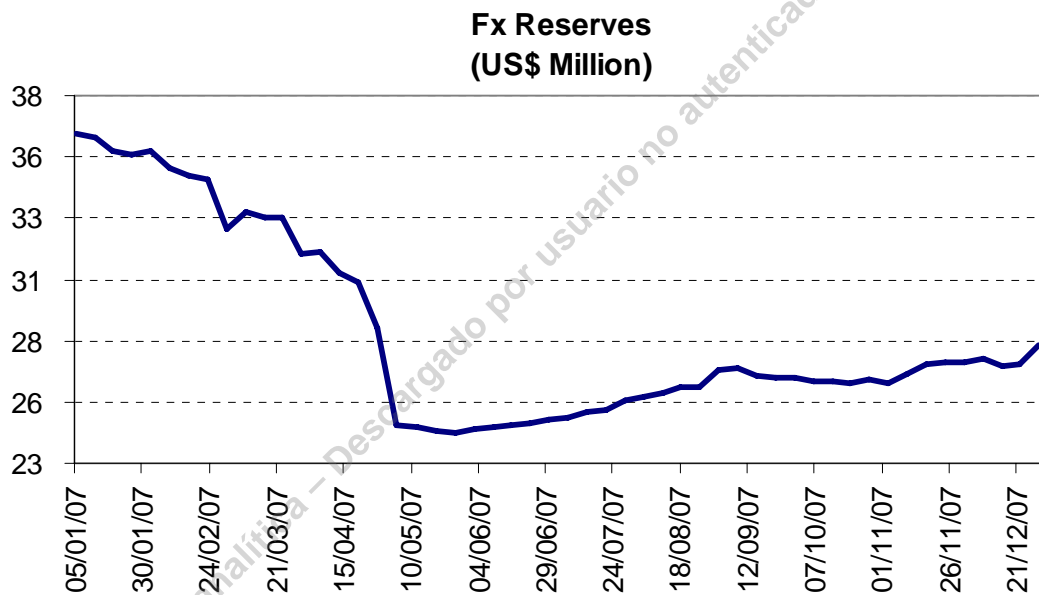
The new dollar accounts managed by the Treasury are yet another example of the Executive's murky ventures

According to figures published by the Central Bank of Venezuela (BCV), oil income during the first two months of the year fell by 45.2% in nominal terms, mainly driven by a 52.3% fall in royalties. This drop in royalties is likely caused by PDVSA paying out Dollars without reporting them to the BCV. Evidently, what the Government is doing is creating a new "fund" which no one knows anything about and which holds resources in hard currency, but no one knows where, and no one knows which exchange rate will be used to sell this currency. Considering oil prices, production levels and the tax figures published by the BCV, **Ecoanalítica** reckons that this new "piggy bank" of the public finances could now hold about US\$ 1.1 billion, a figure that for the time being does not affect the analysis we present below.

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We expect international reserves to stabilize in May, and then grow to US\$ 27.8 billion during the second semester

The fall in international reserves has occurred due to a series of reasons that have no reason to recur again during the second semester. Transfers to FONDEN are done and there should not be any more transfers between now and the end of the year. We do not expect PDVSA to make another speculative attack against reserves (i.e., a new mega-issue of bonds). If we also consider that there will be a lesser expansion in real terms of fiscal expenditure and oil prices will tend to slow down slightly, international reserves should close 2007 at around US\$ 27.8 billion, a 12.3% increase.



Sources: BCV and Ecoanalítica

The problem is that liquidity will increase proportionately more than reserves

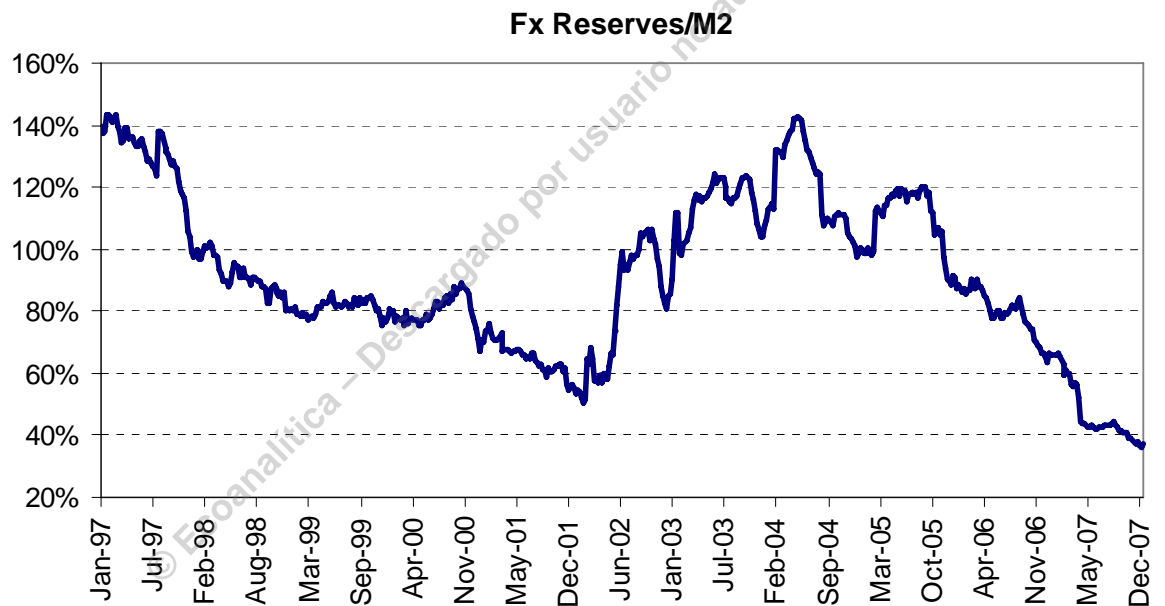
During the first 4 months of the year, liquidity has stayed at about the same levels it had at the close of 2006. However, liquidity tends to increase strongly during the second half of every year. We expect a 34.9% growth for 2007, thus closing the year at VEB 160.2 trillion. We have mentioned several times that one of the main distortions caused by the current economic policy is the huge increase in liquidity due to fiscal squandering and the exchange control.

The percentage of support for the monetary liquidity provided by international reserves will continue to decline

One of the alarming figures we have calculated is that only 44.4% of the monetary liquidity is backed by reserves at the official exchange rate. If liquidity grows more than the reserves, this indicator will tend to deteriorate. Since we do not expect a devaluation of the official exchange rate during the rest of 2007, we anticipate that only 36.8% of

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the liquidity will be supported by international reserves come the end of the year. This situation is particularly critical and points to a devaluation of the official exchange rate to at least VEB 2,500 per US\$ 1 for the first semester of 2008. It has to be emphasized that at the end of 2001, only 50% of the liquidity was backed by international reserves, and that during this scenario of falling oil prices the government was forced to devalue the currency. In fact, in 2002 the exchange rate doubled, moving from VEB 750 per US\$ at the beginning of the year to VEB 1,800 per US\$ at the end of the same year. This action restored monetary equilibrium and provided 100% backing in reserves to liquidity.



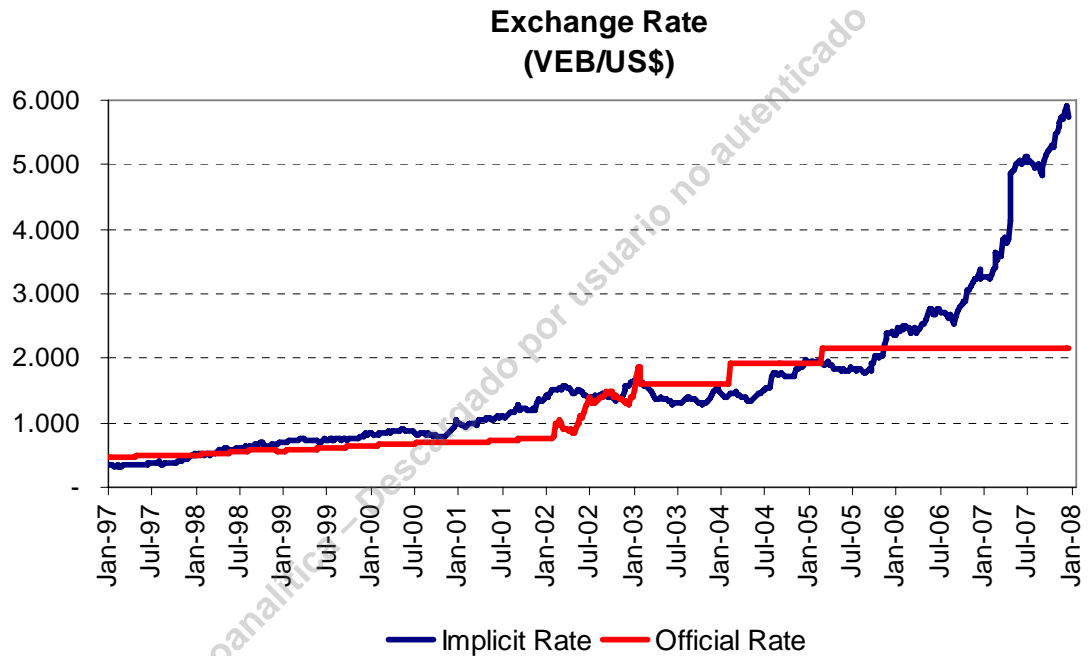
Sources: BCV and Ecoanalítica

Another way to do the same analysis is by tracing the exchange rate necessary for reserves to equal current liquidity

The balanced exchange rate for the monetary market is the result of having international reserves equal 100% of current liquidity. In other words, by devaluating, your reserves back up a higher percentage of your liquidity. It is necessary to point out that this type of liquidity can present certain deviations in respect of the official exchange rate - but a major gap between this type of exchange rate and the official one definitely forebodes inflation.

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The monetary equilibrium exchange rate stood at VEB 4,850 per US\$ 1 at the beginning of the current year, and we expect it to reach about VEB 5,976 per US\$ 1 at year's end. If we look at the percentage difference between the monetary equilibrium exchange rate and the official exchange rate, we find that such difference would increase from 125.6% at the beginning of the year to 178.0% at the end of it. It is clear for **Ecoanalítica** that this distortion cannot be upheld indefinitely, and that it is a clear sign of future devaluation.

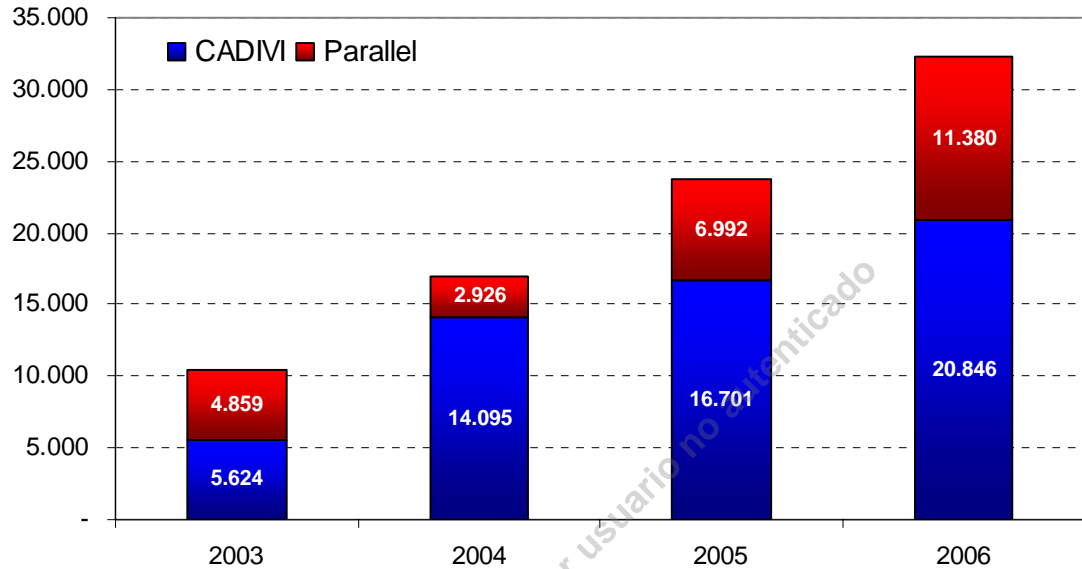


Sources: BCV and Ecoanalítica

Bad monetary policy not the only thing pressuring the unofficial exchange rate - the real sector is too

Another distortion driving the parallel market is the increase in the proportion of imports being financed in this market. The variable of this proportion is increasing at an ever-faster rate. In 2004, of a total of US\$ 17.021 billion in imports, only 17.2% were financed through the parallel market. This proportion has grown to 35.5% of imports which, according to the BCV, stood at US\$ 32.226 billion in 2006. In other words, currency demand on the parallel market increased four-fold in just two years, moving from US\$ 2.926 billion to US\$ 11.380 billion.

Imports (US\$ Billion)



Sources: BCV and Ecoanalítica

Executive still able to partially reduce these distortions, but we have to recommend caution

The increase in short-term risk we are observing could be turned around by the Executive in such a way as to return to a more reassuring scenario. By moderating its fiscal policies, by not continuing to expropriate international reserves and by once again centralizing hard-currency funds in international reserves and in the macroeconomic stabilization fund, it could aspire to lessening these distortions and even restore equilibriums.

It has to be borne in mind that while the distortions we have previously described have been piling up, oil prices have remained high. In other words, during what is left of 2007, and perhaps during the first semester of 2008, Venezuelans will continue to benefit from an income increase that will boost their consumption and will thereby create economic growth. But if appropriate corrective actions are not taken, this *fiesta* will end with a macro-devaluation, a strong rise in inflation and a generalized impoverishment of the people, affecting particularly the low-income population.

Economic Tips

Public spending falls in February. With regard to tax matters, according to the figures published by the Central Bank of Venezuela (BCV), the Central Government's spending for February amounted to VEB 8.0 trillion, an 8% nominal growth and a 9.6% fall in real terms, compared to February of 2006. Total income decreased 8.1% on a year-on-year basis. This fall can be explained by a 36% contraction in oil income on a year-on-year basis. Our opinion is that the fall of oil tax collection has been caused by the institutional changes carried out by the Government thus far, where a significant amount of oil income has been withheld by the National Treasury.

Deficit grows... A VEB 2.5 trillion fiscal deficit was notched up for the second month running. So far this year, the Government's fiscal administration has accounted for a VEB 4.2 trillion deficit, which is very different indeed to the mere VEB 45 billion deficit recorded for the similar period in 2006. Moreover, financing needs soared to VEB 8.6 trillion in the first two months of the year, almost completely covered by drawing down the Central Government's resources in the financial system.

FISCAL BALANCE CENTRAL GOVERNMENT (VEB Billions)	February	February	Nominal	January-February	January-February	Nominal	Real
	2007	2006	Variation	2007	2006	Variation	Variation
Total Revenue	5.512	5.996	-8,1%	12.250	13.105	-6,5%	-21,7%
Non-Oil Revenue	3.939	2.929	34,5%	8.744	6.083	43,7%	20,4%
Oil Revenue	1.573	2.444	-35,6%	3.505	6.398	-45,2%	-54,1%
Central Bank Earnings	-	624		-	624	-100,0%	-100,0%
Total Expenditure	8.046	7.457	7,9%	16.475	13.150	25,3%	4,9%
Primary Expenditure	7.507	6.937	8,2%	15.454	12.110	27,6%	6,9%
Interest Payments	539	520	3,8%	1.022	1.040	-1,7%	-17,7%
Domestic Debt	238	297	-19,8%	524	594	-11,8%	-26,1%
Foreing Debt	301	223	35,3%	498	446	11,7%	-6,5%
Quasifiscal Expenditure	-	-		-	-		
Fiscal Balance	(2.534)	(1.461)		(4.226)	(45)		
Primary Balance	(1.995)	(941)		(3.204)	995		
Non Oil Balance	(4.107)	(4.528)		(7.731)	(7.066)		
Debt Amortization	1.201	1.006		4.373	2.474		
Net Monetary Inyection	5.006	5.312	-5,8%	11.607	9.095	27,6%	6,9%
Financing Requirements	3.735	2.468		8.599	2.519		
Foreing Debt	1	19		3	47		
Domestic Debt	-	-		-	-		
Tresury Bonds	-	-		-	-		
Tresury Debt	-	-		-	-		
Others	3.733	2.449		8.596	2.472		

Sources: BCV and Ecoanalítica

... and net monetary injection pressures liquidity levels. Tax-generated monetary injection was VEB 5 trillion in February this year, a 5.8% decrease compared to February of last year. The situation is totally different if we analyze the figure accumulated during the first two months of the year, since for this period this figure was VEB 11.6 trillion, which represents a 27.6% increase compared to the first two months of 2006. This scenario raises the following question: Are the policies currently carried out by the Government really the right ones to contain liquidity and inflation levels? Obviously not, since the main reason for the explosion of such variables is how badly the National Government has been keeping its own fiscal house in order.

The new argument is “request for consent”. The former director of public credit for the Ministry of Finance, Alejandro Dopazo, has indicated that the Government decision to withdraw from the International Monetary Fund (IMF) should not be cause for alarm, since Venezuela can begin a procedure called “request for consent”, intended to eliminate the obligation to belong to the organization from the underwriting prospectus of sovereign debt.

It is not the first time this has occurred. Dopazo added that the Republic had already used this right in 2004 when it requested, through PDVSA, the consent of the holders of PDVSA Finance securities to modify some of the clauses in the underwriting prospectus. Nevertheless, the withdrawal from the IMF has consequences far deeper than this, since in practice it would imply Venezuela's isolation in international financial markets.

BANDES goes for the third. BANDES is waiting for authorization from the Superintendence of Ecuadorian Banks to open an office in this country, with a capital of US\$ 25 million capital. These resources will be distributed as follows: US\$ 15 million will be destined to reimbursable credits, particularly to micro businesses, and US\$ 10 million will be destined to non-reimbursable loans, particularly to social projects.

And perhaps a fourth one on the way. The employee added that the Bank expects to open an office this month in Nicaragua, with US\$ 20 million in capital.

Substitute for job stability. The Organic Law of Employment Stability will regulate the temporary contracting of workers. The Vice Minister of Labor, Rafael Chacón, explained that the figure of contracts for pre-established periods of time will be kept as part of the regulations, but that companies must guarantee their employees' right to job stability.

Investment receding. The Economic Committee for Latin America and The Caribbean (CEPAL) has warned that the nationalization measures announced in the last few months by the Government may generate greater wariness among foreign investors. The organization announced that Venezuela recorded an investment flight of US\$ 540 million for last year, sharing this position with Surinam, as the only two Latin American countries to lose foreign capital.

But Venezuelan investment overseas has in fact increased. According to the report *Foreign Investment in Latin America and the Caribbean 2006 (La Inversión Extranjera en America Latina y el Caribe 2006)*, created by CEPAL, the flow of Venezuela's direct investment overseas had increased from US\$ 1.183 billion in 2005 to US\$ 2,089 billion by the close of last year, a growth of 76.5% over the results from the previous year. One surprise is that the biggest component of the country's overseas investment portfolio corresponds to PDVSA's accounts receivable for oil sales to overseas companies.

OIL TIPS

Venezuelan crude at a good level. The Venezuelan oil basket closed this week at an average of US\$ 59.50 per barrel, a 2% increase over the previous month, but a 5% fall compared to the same period last year. This is the highest price recorded by the Venezuelan oil basket this year.

CHEVRON does not dismiss the possibility of leaving the country. CHEVRON is considering exiting Venezuela if the terms of the agreements the oil company is negotiating with the Venezuelan State regarding the migration to joint venture companies (*empresas mixtas*) to produce crude in the Orinoco Oil Belt turn out to be "unfavorable". These were the words of CHEVRON's president, David O'Reilly. CONOCO holds the same line.

Extraction in the Faja does not top 430,000 b/d. Luis Vierma, PDVSA's vice president for Exploration and Production, reported that production in the Orinoco Oil Belt ranged from 420,000 to 430,000 b/d, falling by approximately 7% (between 20 and 30 thousand b/d) compared with the previous month. This drop occurred after the assignment of strategic association and at-risk exploration agreements in the Orinoco Oil Belt.

The Government claims another cause. According to Vierma, this fall was caused by the production cut carried out within the framework of the agreements to reduce

OPEC's overall supply. However, the EIA indicates that the fall took place before the cuts were implemented. According to the AIE, Venezuela's production stands at 2.4 million b/d.

Income increase. The increase of royalties from the four associations working in the Orinoco Oil Belt, the introduction of the extraction tax and the increase of the Income Tax rate to 50% for all oil businesses, have resulted in additional tax collections of US\$ 4.2 billion since 2005, according to the Minister of Energy and Petroleum, Rafael Ramirez.

CITGO's president resigns. CITGO's CEO, Félix Rodríguez, has resigned his position, and the president of the affiliate's board of directors and PDVSA's vice president for Refining, Alejandro Granado, was chosen to replace him. Rodríguez had taken over as chief executive of CITGO, PDVSA's subsidiary for refining and commercialization in the USA in January 2005, when he replaced Luis Marín.

Gas distributors prefer nationalization. CONINGAS President, Ángel López, affirmed that CONINGAS members prefer to have the State purchase their companies at a reasonable price than to keep operating with frozen prices and growing costs. CONINGAS represents 85 small- and medium-sized entrepreneurs in the LPG (liquefied petroleum gas) commercialization chain. They assert that costs have increased by 200% since the last price adjustment in January 2004, and that during the last 39 months prices have remained frozen for gas cylinder charging companies, truckers, distributors and final consumers. This situation has resulted in service deficiencies, and persistent shortages in some areas of the country.

BUSINESS SECTOR TIPS

CANTV is a public company once again. According to the Minister of Telecommunications and Computing, Jesse Chacón, the State will have to pay US\$ 1.329 billion for the 400 million share titles obtained, but the real figure is nearer US\$ 1.666 billion if the US\$ 337 million corresponding to 2006 dividends is included. In addition, the resources necessary to acquire CANTV are already available at the BCV, and the transaction will be concluded sometime between May 15 and 18. Control over CANTV will begin on May 21. On closing the transaction last May 8, the Government acquired 79.62%, which, added to the 6.59% shareholding it already possessed, means that it now owns 86.21% of the phone company's equity.

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Let's hope it comes true. Chacon mentioned that 70% of the profits earned by the State from the company's operations will be reinvested in infrastructure and new services to promote the penetration ratio of fixed telephone systems per inhabitant.

Strong increase in private sector sales. BCV indicated that sales volumes increased 45.6% over January 2006. Breaking this down by sectors, wholesale sales increased by 70.3%, while retail sales increased 35.5%. Within the wholesale sales sector the leading categories were: machinery and equipment (80%), textiles and footwear (80%), food and beverages (68%), household equipment (62%), and semi-manufactured products (51%). Within the retail sales sector the following products stand out: textiles and footwear (100%), automobiles (81%), hardware and paint (56%), and shop sales (26%). The only category that decreased was the sale of household devices and appliances (-8%).

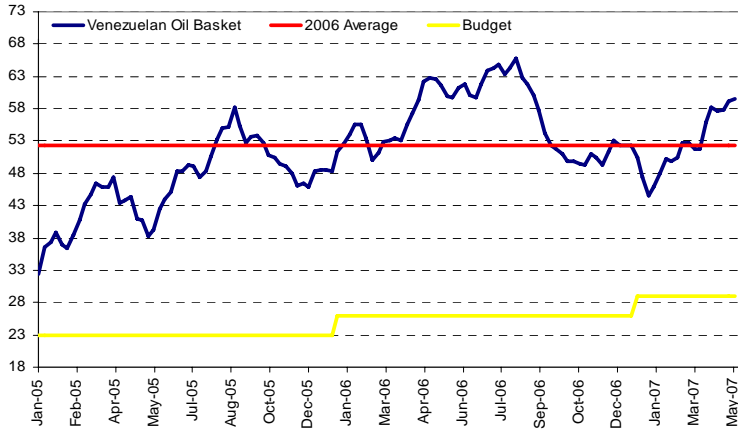
Moderate growth in manufacture. The manufacturing industry grew 6.4% in January of this year compared to the same month in 2007. The total growth of this sector last year was 10.3%. The categories that performed best included: rubber and plastics (26%), metals (20%), and foods and drinks (18%). However, metal products fell 28%, wood decreased 18%, while machinery and equipment and electric equipment fell 11%.

Car sales growing. According to the Venezuelan Automobile Chamber (CAVENEZ), the accumulated number of new cars sold in Venezuela between January and April of this year was 130,956 units, which represents a 52.4% increase over the 85,957 cars sold in the same period last year.

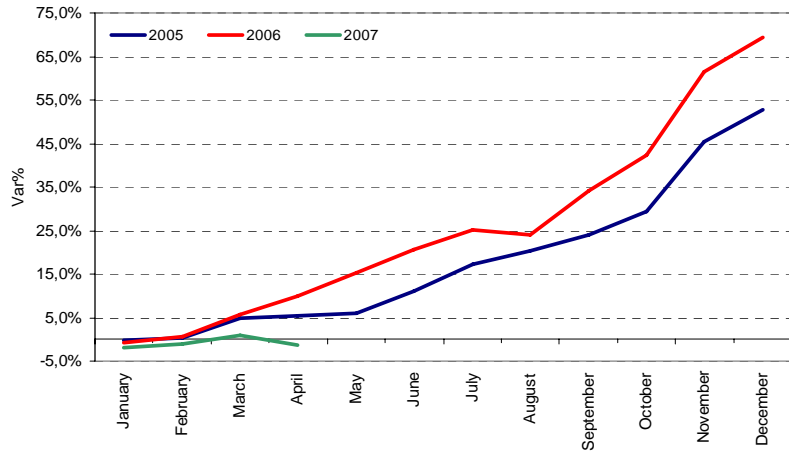
Polar increased its food production. Polar increased its food production by 17% in March 2007 compared to the same period last year.

ECONOMIC OVERVIEW

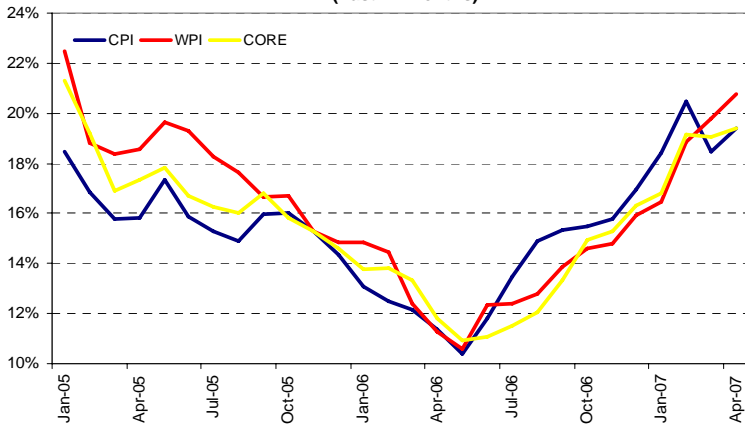
Oil Price
(Venezuelan Basket US\$/pb)



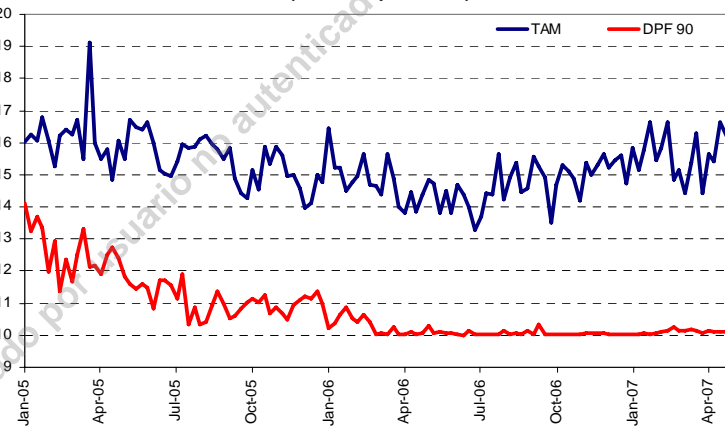
Real Expansion (M2)



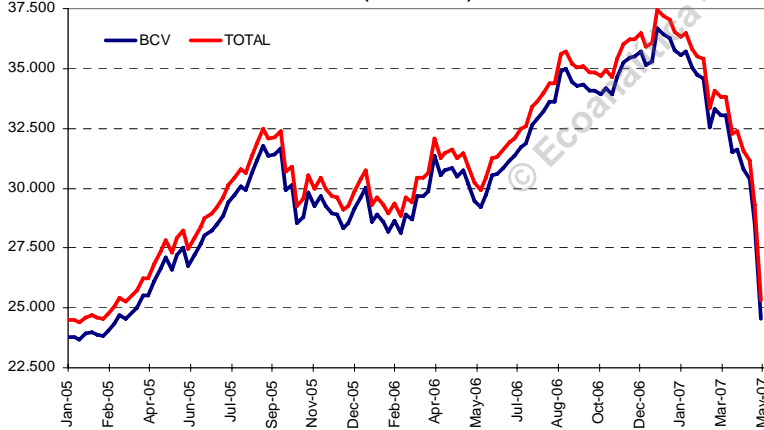
Inflation
(Last 12 Months)



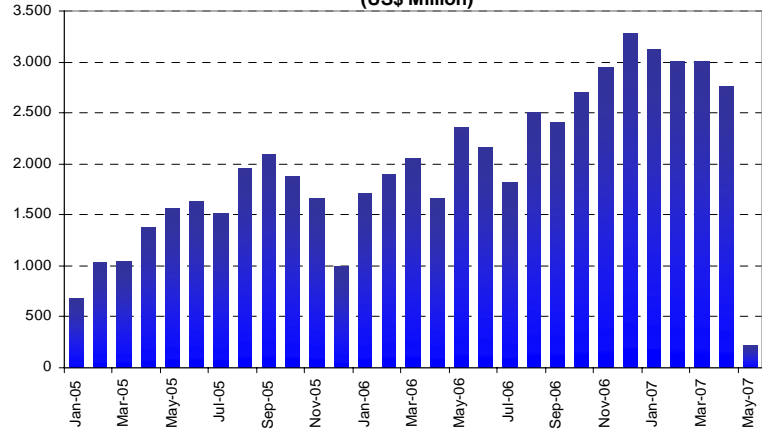
Interest Rate
(Six Principal Banks)



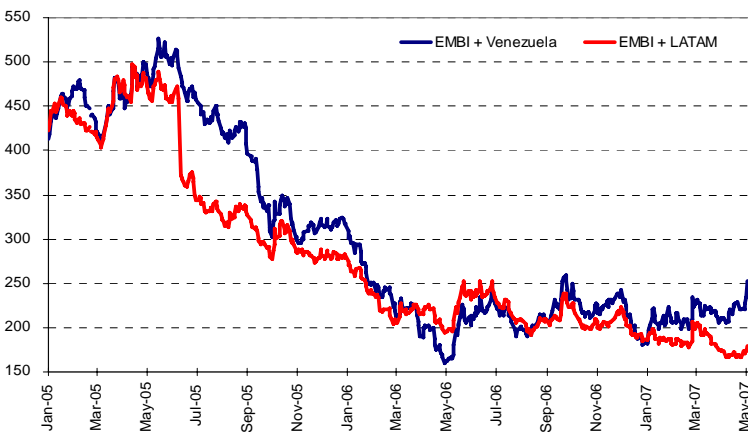
Fx Reserves
(US\$ Million)



Disbursement
(US\$ Million)



EMBI



Central Government
(VEB Billion)

